

A Comparison of EU and China Competition Laws that Apply to Technology Transfer Agreements

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Abstract: A comparison of European Union (EU) and Chinese competition laws that apply to technology contracts indicates that China's laws are more protective of the recipient of the technology in several important aspects. In this context, technology transfer refers to access given by the owner of technology embodied in intellectual property rights, such as patents, trademarks, and copyrights, to a third party. This transfer usually occurs in the form of a licensing agreement, in which the owner of the technology licenses or authorizes the licensee to use the proprietary technology in exchange for a payment of royalties. Since advanced technology is an essential component in modern international business and trade, and since the ownership of intellectual property rights creates monopoly rights in the owner, the licensing of such rights by the owner gives rise to potential for abuses in the licensing agreement that might impose onerous burdens on the licensee. Technology transfer laws are a set of competition laws designed to allow the owner of the technology to reap a fair return for providing access to the technology, but are also designed at the same time to protect the licensee from exploitation by the licensor. This article indicates that China's laws are more protective of the licensee, usually a Chinese business entity, than comparable laws in the EU. These protective features can

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place the licensor, usually a multinational company (MNC), at risk. This article then draws some general conclusions about China's attitudes toward technology licensing in general to provide some guidelines for U.S. companies that seek to invest in China and to license their technologies to business entities in China.

I. INTRODUCTION

Among the most important concerns of U.S.-based MNCs doing business abroad are laws concerning technology transfer. As further explained below, technology transfer refers to the granting of access by an owner of technology or information usually protected by statutory intellectual property rights to a separate party.¹ Technology transfer has become an essential component in most sophisticated international business transactions and is closely related to the topic of protecting intellectual property rights, a core issue in modern international business.² Both the European Union (EU) and the People's Republic of China (PRC or China) have extensive competition laws concerning technology transfer.³ According to many experts, EU competition law is the most complex and sophisticated in the world.⁴ In fact, China has studied and used EU law, rather than U.S. law, as a model for its competition laws.⁵ The technology transfer laws in both the EU and China are important because both the EU and China are major destinations for U.S. companies that seek to do business abroad.⁶ Understanding laws relating to technology transfer in the EU

¹ See *infra* Part II.A.

² See DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 324-25 (2d ed. 2010) [hereinafter *INTERNATIONAL BUSINESS TRANSACTIONS*].

³ See *infra* Part III.

⁴ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 2, at 314.

⁵ DANIEL C.K. CHOW & ANNA M. HAN, DOING BUSINESS IN CHINA: PROBLEMS, CASES, AND MATERIALS 227 (West 2012) [hereinafter *DOING BUSINESS IN CHINA*].

⁶ The EU is the largest recipient of foreign direct investment in the world. *Foreign Direct Investment*, EUROPEAN COMMISSION, http://ec.europa.eu/economy_finance/eu/globalisation/fdi/index_en.htm (last updated Mar. 15, 2011). China is the second largest recipient of foreign direct investment in the world. UNCATD, *Global Investment Trends Monitor No. 11*, UNCATD (Jan. 23, 2013), at 3, http://unctad.org/en/PublicationsLibrary/webdiaeia2013d1_en.pdf.

and China is essential to any successful strategy for MNCs in the modern global economy.

This article compares the laws pertaining to technology transfer in the EU and China and argues that China's laws are, in general, much more protective of the recipient of the technology (usually a Chinese business entity) in several crucial respects. As we shall see, China's laws, unlike EU law, are purposely left broad and subject to expansive interpretations in several areas. This approach is consistent with China's approach to law in general, which is to construct laws that allow the enforcement and implementing authorities to exercise discretion in how the laws are interpreted and applied.⁷ From the perspective of an MNC doing business in China, several important lessons can be drawn from this analysis. MNCs can be vulnerable in a number of respects, and can find that their technology might be compromised under China's laws, unless careful steps in the planning stages are taken. From a larger perspective, China's laws appear to still contain protectionist elements that might prove disadvantageous to MNCs and to China's reputation in general as a place to do business.⁸ China justifies its position on the basis that it is still a developing country that does not trust owners of advanced technology, often MNCs from advanced industrialized countries.⁹ Some U.S. companies believe that China's more restrictive laws are designed to force companies to set up their own operations in China as opposed to transferring technology to an unaffiliated Chinese entity.¹⁰

Part II of this article will examine technology transfer in modern international business and the concerns that it raises for the owners of technology, the transferor in a technology transfer arrangement, and the recipients of technology transfer. Part III will examine the legal regimes in the EU and in China applicable to technology transfer and will focus on three crucial aspects in which EU and Chinese laws differ. In each case, Chinese law seems to be designed to be more protective of the recipient of the technology than EU law. Although this article focuses on these three aspects, many more examples exist that are too numerous to discuss in detail in this study. Part IV draws

⁷ See *infra* Part III.B.

⁸ See *infra* Part III.C.

⁹ See *infra* Part IV.

¹⁰ See *id.*

some conclusions and provides some suggestions for MNCs to handle the risks created by China's technology transfer legal regime.

II. TECHNOLOGY TRANSFER IN MODERN INTERNATIONAL BUSINESS

A. *The Importance of Technology Transfer*

In the modern global economy, the value of knowledge, business know-how, and information are more important than ever in determining success in international business.¹¹ In the past, an MNC might count physical assets as its most valuable business aspects, such as inventory, raw materials, machinery, and other brick and mortar assets.¹² That was in a different era. Today, an MNC considers its technology-knowledge that is protected by patents, trademarks, copyrights, and trade secrets—its most important business asset.¹³ Modern studies show that a product's competitiveness is directly tied to its level of technology; the more advanced the technology embodied in the product, the more competitive the product becomes in the modern world economy.¹⁴ A multinational pharmaceutical company, such as Pfizer, considers its core business assets to be its portfolio of patents, trademarks, and other intellectual property rights. MNC pharmaceutical companies earn billions of dollars per year through the sale of patented drugs and find that these sales plummet as soon as the patent expires and generic drugs enter the market.¹⁵ Consumer products companies, such as Coca-Cola and McDonald's, count their brands (or trademarks) as their most valuable business assets.¹⁶ The

¹¹ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 2.

¹² See DANIEL C.K. CHOW & EDWARD LEE, INTERNATIONAL INTELLECTUAL PROPERTY: PROBLEMS, CASES, AND MATERIALS 442 (2d ed. 2012) [hereinafter *INTERNATIONAL INTELLECTUAL PROPERTY*].

¹³ See *id.* at 443.

¹⁴ DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL TRADE LAW: PROBLEMS, CASES, AND MATERIALS 587 (2d ed. 2013) [hereinafter *INTERNATIONAL TRADE LAW*].

¹⁵ See, e.g., Caroline Humer, *Generics Brought Down Common Drug Prices in 2012*, REUTERS (Mar. 5, 2013, 12:15 AM), <http://www.reuters.com/article/2013/03/05/us-expressscripts-prices-idUSBRE92406W20130305>.

¹⁶ See CHOW & LEE, INTERNATIONAL INTELLECTUAL PROPERTY, *supra* note 12, at 443.

value of the Coca-Cola trademark alone is worth tens of billions of dollars, at the very least, and possibly much more.¹⁷

When MNCs do business abroad, several types of transactions involve technology transfer. In general, the more sophisticated the international business transaction, the greater the likelihood that a form of technology transfer will be involved. Suppose that an MNC wishes to hire a foreign company to manufacture its products abroad.¹⁸ For example, the MNC may wish to employ a company in Germany or China to make its products for the EU and Chinese markets. Hiring a company to manufacture products locally, called contract manufacturing, will save the MNC costs in time and shipping that would be involved if the MNC manufactured all of its products in the U.S. and then shipped the products by ocean transport to the target market.¹⁹ Contract manufacturing is quite common in international business and is the exclusive method by which some MNCs do business abroad.²⁰ In order to allow the contract manufacturer to successfully manufacture the product, however, the MNC, as the owner of the technology, must give the contract manufacturer access to its proprietary technology.²¹ For example, if the contract manufacturer is producing a drug or a laundry detergent, the MNC will need to give the contract manufacturer access to the technology, usually protected by patents and trade secrets, before the product can be made according to specifications.

A second type of transaction, also very common in modern business, involves an MNC setting up its own business entity abroad

¹⁷ See *id.* Coca-Cola's brand (its trademark) was valued at \$77.8 billion in 2012, making it the most valuable brand in the world. See *Best Global Brands 2012*, INTERBRAND available at <http://www.interbrand.com/en/best-global-brands/2012/Best-Global-Brands-2012-Brand-View.aspx> (last visited Aug. 25, 2013). This does not mean that Coca-Cola would be willing to sell their trademark for that amount. Coca-Cola's total annual revenue, based upon the success of the Coca-Cola trademark and other marks, was \$46.5 billion in 2011 (according to their annual review).

¹⁸ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 2, at 323.

¹⁹ See *id.*

²⁰ See Steven Van Dusen, *The Manufacturing Processes of the Footwear Industry: Nike Versus the Competition*, <http://www.unc.edu/~andrewsr/intso92/vandu.html> (last visited Aug. 25, 2013).

²¹ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 2, at 298.

rather than hiring a contract manufacturer.²² Many MNCs believe that setting up their own business entities, either as joint venture partners with local companies or wholly owned subsidiaries, offers many advantages to entering into a contract licensing agreement with a third party. The MNC may not be that familiar with the third party or may not trust the third party entirely. This type of transaction is commonly referred to as foreign direct investment (FDI) and is characterized by the establishment of a business entity in which the MNC has a lasting ownership and management control.²³ Instead of establishing a new or “greenfield” investment, many MNCs acquire an existing foreign company through a merger or acquisition.²⁴ An acquisition offers the advantages of immediate market penetration because the target company will have an existing network of customers and goodwill and economies of scale that can redound to the benefit of the MNC at home and abroad created by combining resources with an existing successful business entity.²⁵ As in the case of contract manufacturing, however, the foreign business entity, even if it is a wholly owned subsidiary, newly established or acquired, will not be able to manufacture the products without the technology owned by the parent MNC. In other words, the MNC will need to transfer technology to the foreign business entity in order for it to operate successfully.²⁶

B. The Process of Technology Transfer

MNCs that engage in technology transfer generally use the following procedure: the MNC first registers and obtains a patent, trademark, copyright (or other intellectual property rights) under national law and then licenses the patent, trademark, copyright, or other IP right to a licensee in a foreign country in a patent licensing agreement or a mixed agreement (e.g., patent and trademark).²⁷ Under the principle of territoriality, a patent, trademark, copyright or

²² See *id.* at 366.

²³ See *id.*

²⁴ See *id.* at 369-370.

²⁵ *Id.* at 370.

²⁶ See *id.* at 495.

²⁷ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 321.

other intellectual property right creates rights that are effective only within the territory of the country creating or recognizing the rights.²⁸ For example, an MNC that owns a patent or trademark registered in the U.S. has a patent or trademark effective only within the U.S. If the MNC wishes to obtain a patent or trademark right in Germany or China, the MNC first must separately file and register a patent or trademark in the foreign country. Each patent or trademark (or other IP right) is a separate and independent creation of the law of the country in which the right is registered or recognized.²⁹ The MNC can then transfer the patent, trademark, or other IP right to the transferee, either a contract manufacturer or a business entity that is partially or wholly owned by the MNC.³⁰ The transfer can be in the form of an assignment or, most commonly, in the form of a license through a written licensing agreement.³¹

Most MNCs follow this procedure in order to establish that the MNC is the owner of the IP right and that the transferee is a licensee.³² An IP owner never wants to get into a dispute or controversy over who owns the IP right as this can lead to time-consuming disputes and needless litigation. Even worse, if the MNC loses the IP right, the foreign entity might become the owner of the IP right in the foreign country. Imagine if a German or Chinese company were to become the legal owner of the Coca-Cola trademark in Germany or China. This would be a business catastrophe for the MNC.³³ If the MNC registers the patent or trademark in its own name, however, the MNC is the owner of the IP rights and the licensee only has permission to use the IP right. If business relations sour or conditions change, the licensing agreement should have a termination clause that would allow the

²⁸ See CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 2, at 327.

²⁹ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 320.

³⁰ See *id.* at 321.

³¹ An assignment is the transfer of complete ownership rights of the intellectual property by the owner to the buyer. If the technology is commercially valuable, most owners of the technology are reluctant to sell the technology, although the owner might be willing to license it. In a licensing agreement, the licensor remains the owner of the technology. See CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 2, at 324-25.

³² See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 321.

³³ See *id.* at 322.

MNC or licensee to terminate the licensing agreement.³⁴ Once the agreement is terminated, the MNC remains the owner of the patent, trademark, copyright, or trade secrets.³⁵

The written licensing agreement is a form of technology transfer that is subject to regulation in both the EU and China by competition laws. Note that technology transfer is not regulated by any rules under the World Trade Organization (WTO).³⁶ Although the WTO regulates trade in technology under the Agreement on Trade Related Intellectual Property Rights (TRIPS), the main purpose of TRIPS is to set forth minimum standards for all important intellectual property rights (e.g. patents, trademarks, copyrights, trade secrets, and several others) and to create enforcement obligations.³⁷ TRIPS does not regulate technology transfer or licensing agreements, so this field is left to regional and domestic legislation.³⁸ In other words, there is no higher forum in which to challenge EU or Chinese competition law than in the EU or China itself.

³⁴ See *id.* at 321.

³⁵ See *id.*

³⁶ See *Understanding the WTO*, WTO, http://www.wto.org/english/thewto_e/whatis_e/what_we_do_e.htm (last visited Aug. 25, 2013). The purpose of the WTO is to provide a forum in which WTO members, which now number 159 states, can lower trade barriers and discuss and resolve trade disputes. The WTO administers three major trade agreements: the General Agreement on Tariffs and Trade (trade in goods), the General Agreement on Trade in Services (trade in services), and the Agreement on Trade Related Intellectual Property Rights (trade in technology). See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 14, at 28.

³⁷ See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 14, at 590-91.

³⁸ TRIPS does relate to technology transfer in some indirect ways. For example, Article 31 of TRIPS provides for a compulsory license for a patent, i.e. a license that is imposed upon the patent owner under certain circumstances. In the WTO, the compulsory licensing provision has been used to create pressure on pharmaceutical companies to provide access to medicines protected by patents that would be otherwise too expensive for the countries that seek the medicines. See CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 2, at 589-93. This is not the type of technology transfer that is the main subject of this article, which are voluntary transfers set forth in a written licensing agreement. TRIPS does not govern these types of agreements. The type of technology transfers discussed in this article are subject to what are generally considered to be competition laws, as discussed in further length in the article. Competition law is not the subject of the WTO (with the minor exception of the Telecoms Agreement, an annex to the General Agreement on Trade in Services, which applies only to some aspects of telecommunications services and is not relevant to the technology transfer agreements discussed in this article. See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 14, at 557.

Technology transfer in the form of licensing agreements is subject to competition law because many countries are concerned that subject agreements may lead to anticompetitive effects detrimental to the local economy.³⁹ Intellectual property, such as a patent, creates a monopoly right in itself, and the licensing of that right to another might extend that monopoly power of the owner of the patent in a fashion that creates harmful effects on competitors. A patent owner, unable to fully exploit the patent in a foreign country, might be able to exploit the patent by licensing it to a local company in the foreign country. In the process, however, the patent owner might impose onerous conditions in the licensing agreement that exploit or disadvantage the licensee, itself a competitor of the licensor. This type of concern is of special importance to developing countries, which might believe that the inexperience of their business entities in dealing with sophisticated MNCs places them at a significant disadvantage when negotiating a licensing agreement, and might lead to their exploitation by the MNC.

These concerns lead some countries to enact laws designed to protect the transferee or licensee of the technology. This article focuses on three of the more common concerns. First, the licensor will license only secondary or outdated technologies while keeping core or advanced technologies in-house.⁴⁰ This is a concern for all licensees, but particularly those in developing countries, such as China. The licensee is concerned that it is paying for a technology that is not really valuable because it is not cutting edge or the most advanced technology available. As we noted earlier, competitiveness in the modern economy is directly linked to the level of technology, and so naturally the licensee wants access to the most advanced technology. On the other side, the MNC and owner of the technology might be reluctant to part with its most advanced or core technology since it is a crucial business asset. As in any licensing agreement, the MNC might be concerned that the technology, once licensed, might be

³⁹ See Part III *infra*. This section discusses competition law applicable to technology transfers in the EU, China, and the U.S. However, many other countries have competition laws that apply to technology transfer; these laws are in most cases domestic laws of a country, although in the case of the EU, competition law is regional law. There is no true international treaty that applies technology transfer on par with the WTO treaties on trade in goods, services, and technology. See note 38 *supra*. Although there has been some discussion within the WTO of a general agreement on competition, there does not appear to be sufficient political will to create such an agreement, given the other priorities of the WTO.

⁴⁰ See *infra* Part III.

misappropriated or stolen. The higher the level of technology concerned, the greater the risk, so some MNCs will not license their most valuable technologies but keep them safely in-house.

Second, the licensor might limit the use of the license by putting in restrictions as to territory, quantity of products that can be manufactured, and the sales price of the product.⁴¹ For example, the licensor might restrict the licensee to sales of the product in Germany or in China, or even in parts of those countries with the idea that the licensor will either sell directly to other territories or might enter into separate licensing agreements with other entities for those territories. The licensor might also limit the amount of products that can be produced in order to sustain a higher price for the product and avoiding flooding the market with products. The licensor might also want to set a price at which the product can be sold in the target market. All of these types of restrictions are viewed as having anticompetitive effects.

Third, the licensor will put in so-called grant-back clauses, providing that the licensor owns any improvements to the technology made by the licensee.⁴² In any patent license agreement, the licensee, in making use of the patent, may discover improvements to the patent. For example, a licensee of a patent for a laundry detergent might find that due to differences in the water in China that a change in the enzyme formula might make the detergent more effective. Since the technology transfer agreement only covers the basic patent, an issue arises over who owns the improvement. On the one hand, the licensor will argue that it owns the improvement, since it owns the basic technology without which the improvement could not have been made. On the other hand, the licensee will argue that it owns the improvement since it actually invented the improvement in the course of using the patent. The improvement itself might qualify for a separate patent on its own. As improvements are common in patent licensing agreements, the licensor might put in a grant-back clause that requires the licensee to grant all improvements back to the licensor. Such a grant-back clause would resolve all doubt about who owns the technology. In addition, the licensor might put in the agreement a clause that prohibits the licensee from making any improvements at all, which would also resolve any issues over who owns the improvement.

⁴¹ See *id.*

⁴² See *id.*

These types of issues arise on a regular basis in technology licensing agreements and both the EU and China regulate these issues through competition laws. Of course, there are many other issues that arise in technology transfer, which are too numerous to examine in this study, but the treatment of these issues by the EU and China are representative of how these two jurisdictions handle technology transfer issues and offer some valuable lessons for MNCs seeking to do business in the EU and China.

III. EU AND CHINA COMPETITION LAWS THAT APPLY TO TECHNOLOGY TRANSFER

Both EU and China have extensive competition law regimes that are designed to protect the licensee from anticompetitive restrictions in the technology transfer agreement. The discussion below focuses on how these laws treat the three major issues set forth in Part II above: territorial restrictions, grant-back clauses, and level of technology transferred, but note that both sets of laws are comprehensive and deal with issues not discussed in this article.

A. *Overview of EU Competition Law*

EU competition law stems from Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU),⁴³ which is designed to create a common market among all 27 EU member states.⁴⁴ TFEU Article 101, which is analogous to Section 1 of the U.S. Sherman Act,⁴⁵ prohibits agreements, decisions by associations, and concerted practices that have, as their object or effect, the prevention, restriction or distortion of competition that affect trade within

⁴³ Consolidated Version of the Treaty on the Functioning of the European Union art. 101-02, May 9, 2008, 2008 O.J. (C 115) 47 [hereinafter *TFEU*].

⁴⁴ The European Union is an economic, political, and monetary union of 27 states that have signed important treaties delegating sovereign powers to pan-European institutions. For the purposes of this article, the most important aspect is the goal of the EU to create a single market for all 27 states; an important aspect of this goal is to eliminate trade barriers created by individual nations. Competition law plays a paramount role in achieving this objective since protectionist trade barriers created by individual EU states are anti-competitive. For a summary of the EU and its basic pan-European institutions, see CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 2, at 43-45.

⁴⁵ 15 U.S.C. §§ 1-7 (2006).

member states.⁴⁶ TFEU Article 102, which is analogous to Section 2 of the U.S. Sherman Act,⁴⁷ addresses issues of monopolization and abuse of a dominant position.⁴⁸

⁴⁶ TFEU Article 101 provides:

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices, which may affect trade between member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
 - (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
 - (b) limit or control production, markets, technical development, or investment;
 - (c) share markets or sources of supply;
 - (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
 - (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
 - Any agreement or category of agreements between undertakings;
 - Any decision or category of decisions by association of undertakings
 - Any concerted practice or category of concerted practices,

For the purposes of this article, TFEU Article 101 is more pertinent as it applies to technology licensing agreements, which could qualify as agreements that have anticompetitive effects within the meaning of TFEU Article 101.

The structure of TFEU Article 101 is as follows: Article 101(1) sets forth the general prohibition covering agreements that could have an anti-competitive object or effect within the common market; Article 101(2) states that such agreements are void; and Article 101(3) states that the prohibitions set forth in Article 101(1) can be declared inapplicable by the EU Commission, the executive arm of the EU,⁴⁹ if certain circumstances are found to exist. If the EU Commission declares the prohibition in Article 101(1) to be inapplicable through a regulation called a “block exemption” then any agreement falling within the block exemption is permitted.⁵⁰ In other words, the general approach of the EU is to set forth a wide prohibition, and then to issue exemptions to those prohibitions creating a “safe harbor” for agreements falling within the block exemptions. We will consider a block exemption applicable to technology transfer agreements in the discussion below, but there are many such block exemptions, as well as judicial decisions by the European Court of Justice (ECJ)

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- Which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

⁴⁷ See *id.*

⁴⁸ See TFEU *supra* note 43.

⁴⁹ The EU Commission, the executive arm of the EU, is charged with administration and enforcement of EU law. Currently each member state is allocated one commissioner until 2014, when the number of Commissioners will be reduced to two thirds of the number of member states. See CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 2, at 44.

⁵⁰ See *id.* at 315.

interpreting both the TFEU and the block exemptions so the jurisprudence on European competition law is expansive. The ECJ has exclusive jurisdiction to interpret EU law and the power to require compliance with EU treaties or EU law by member states.⁵¹

B. *Overview of Chinese Competition Law*

As noted earlier, lawmakers in China studied and borrowed from EU competition law in creating China's modern competition law. In part, this is due to China's use of a civil law system, similar to the system followed in Europe.⁵² Under a civil law system, the law is created primarily through statutes,⁵³ as opposed to a common law system followed by the U.S. in which courts and judicial decisions play a prominent role in establishing the law. For example, in deciding whether agreements violate Section 1 of the Sherman Act applying to agreements with anticompetitive effects, the U.S. applies a "rule of reason" that is expounded by the courts through written opinions.⁵⁴ Such an approach would never be practicable in China. Courts do not enjoy the stature of a co-equal branch of government as they do in the U.S., but are instead viewed as subordinate to the legislative branch.⁵⁵ Court decisions are not viewed as authoritative by some administrative agencies,⁵⁶ have no precedential value,⁵⁷ and many

⁵¹ See *id.* at 44.

⁵² See Heidi Hansen Kalscheur, *About "Face": Using Moral Rights to Increase Copyright Enforcement in China*, 39 HASTINGS CONST. L. Q. 513, 517 (2012).

⁵³ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 2, at 455.

⁵⁴ See *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1, 62 (1911) ("[T]he criteria to be resorted to in any given case for the purpose of ascertaining whether violations of the section have been committed is the rule of reason guided by the established law . . ."); see also *Board of Trade of City of Chicago v. United States*, 246 U.S. 231, 239 (1918) (holding that a restraint on the hours of trade is a reasonable regulation).

⁵⁵ See DANIEL C.K. CHOW, THE LEGAL SYSTEM OF CHINA IN A NUTSHELL 198 (2d ed. 2009) [hereinafter, CHOW, *LEGAL SYSTEM OF CHINA*]. Another issue with the courts is whether they are independent of the other organs of government or of the Communist Party. See *id.* at 198-202.

⁵⁶ See *id.* at 226-27.

⁵⁷ See *id.* at 214.

court decisions are never issued in the form of a written opinion.⁵⁸ Additionally, there is no official reporting system for most judicial decisions.⁵⁹ Rather, China has followed the EU approach of setting forth standards in statutes that are then applied, not by courts, but by administrative authorities, most notably the powerful Ministry of Commerce (MOFCOM), which appears to be the final authority on most issues of competition law in China.⁶⁰

The primary legislation relating to competition is the Anti-Monopoly Law (AML), issued in 2007 after more than a decade of deliberation and effective as of August 1, 2008. AML Article 1 states as follows:

This Law is formulated to prevent and deter monopolistic conduct, ensure fair market competition, increase economic operation efficiency, protect consumer interests and social public interest, and facilitate the dynamic development of the socialist market economy.⁶¹

AML Article 3 defines monopolistic conduct to include “monopoly agreements” and “abuse of a market dominant position.”⁶² These

⁵⁸ See *id.* at 215.

⁵⁹ See *id.*

⁶⁰ See MOFCOM (May 22, 2013), <http://english.mofcom.gov.cn>.

⁶¹ See Anti-Monopoly Law (Adopted at the 29th Session of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on Aug. 30, 2007) Art. 1. [hereinafter *AML*].

⁶² Article 3 provides in full as follows:

For purposes of this Law, monopolistic conduct includes:

- (1) Conclusion of monopoly agreements by business operators;
- (2) Abuse of dominant market position by business operators; and
- (3) Concentration of business operators that results in or is likely to result in any effect of excluding or limiting competition.

Article 3(3) refers to mergers and acquisitions. As a result of Article 3(3), many mergers and acquisitions need prior approval by MOFCOM. See AML, arts. 20-31. The State

forms of prohibited conduct appear to be similar to the type of collusive agreements prohibited under TFEU Article 101(1) and Section 1 of the Sherman Act.⁶³ AML Article 13 specifies in greater detail what type of agreements are prohibited, including those that fix prices, limit production quantity, and divide markets.⁶⁴ Abuse of a dominant market position, prohibited by AML Article 1 and further elaborated on in AML Articles 17-20,⁶⁵ is analogous to TFEU Article 102 and Section 2 of the Sherman Act.⁶⁶ Unlike the EU, however, China does not use a system of block exemptions to create safe harbors. Rather, China has a patchwork of other laws that apply to technology transfer agreements, including the Foreign Trade Law,⁶⁷ the Anti-Unfair Competition Law,⁶⁸ the Regulations on Administration of Technology Import and Export,⁶⁹ the Contract Law⁷⁰ and other laws and regulations.⁷¹ China also has many local laws and regulations. Although local laws cannot contradict national level laws, local laws, regulations, notices and orders are often more detailed than their national counterparts and so it becomes essential

Council has delegated authority to review mergers and acquisitions to MOFCOM. *See* CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 223.

⁶³ *See supra* Part III.A.

⁶⁴ *See* AML, art. 13.

⁶⁵ *See* AML, arts. 17-20.

⁶⁶ *See supra* Part III.A.

⁶⁷ *See* Foreign Trade Law (Adopted at the 7th Meeting of the Standing Committee of the Eighth National People's Congress on May 12, 1994, revised at the 8th Meeting of the Standing Committee of the Tenth National People's Congress and promulgated by Order No. 15 of the President of the People's Republic of China on April 6, 2004).

⁶⁸ *See* Anti-Unfair Competition Law (Adopted at the Third Session of the Standing Committee of the Eighth National People's Congress on September 2, 1993).

⁶⁹ *See* Regulations on Administrations of Technology Import and Export (Promulgated by the State Council on 10 December 2001 and effective as of January 1, 2002).

⁷⁰ *See* Contract Law (Adopted at the Second Session of the Ninth National People's Congress on March 15, 1999).

⁷¹ *See* CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 358 (discussing other laws such as List of Technologies Prohibited or Restricted from Being Imported, issued by the Ministry of Commerce and State Economic Trade Commission (2001), and the List of Technologies Prohibited or Restricted from Being Exported, issued by MOFCOM and the Ministry of Science and Technology (2001)).

for an MNC to understand, not only national, but also local legislation.⁷² In addition, China is constantly churning out new laws and other legal documents at the national and local levels. Any technology transfer agreement is potentially subject to restrictions contained in any or all of these laws.

C. A Comparison of EU-China Competition Laws Applicable to Territorial Restrictions, Grant-Back Clauses, and Level of Technology Transferred

1. EU Regulations Relating to Territorial Restrictions

EC Regulation No. 772/2004⁷³ creates a block exemption for certain categories of technology transfer agreements. As noted earlier, an agreement falling under a block exemption issued pursuant to TFEU Article 101(3) is given a safe harbor and is considered to be exempt from the general prohibition against agreements with anticompetitive effects set forth in TFEU Article 101(1). Article 2 of the EC Regulation No. 772/2004 defines a technology transfer agreement to include “a patent licensing agreement, a know-how licensing agreement or software copyright licensing agreement.”⁷⁴ Under Article 2, a technology transfer agreement also includes a mixed patent, know-how, and trademark licensing agreement or a mixed agreement containing provisions related to the sale of productions provided, that the sale is directly related to the production of the contracted products. Article 2 provides that, assuming all of the conditions of the EC Regulation No. 772/2004 are met, the agreement is exempt from the prohibition against anticompetitive agreements contained in TFEU Article 101(1).⁷⁵ Article 3 of the Regulation further provides that the combined market share of the parties to the agreement must not exceed certain thresholds: 20 percent on the affected relevant technology and product market where the parties are

⁷² See *Local Legislation in China*, CHINA THROUGH A LENS, <http://www.china.org.cn/english/kuaixun/76344.htm> (last visited May 28, 2013) (“Local legislation is an important aspect of the whole legislative system of the country.”).

⁷³ See Commission Regulation 772/2004, on the Application of Article 81(3) of the Treaty to Categories of Technology Transfer Agreements, 2004 O.J. (L 123) 11 (EC).

⁷⁴ See *id.* at art. 1.1(b).

⁷⁵ See *id.* at art. 2 (Exemption).

non-competing undertakings, and 30 percent where the parties are competing undertakings.⁷⁶

Where the parties are competing undertakings,⁷⁷ the licensor is allowed to restrict active or passive sales of the licensee into another territory reserved by the licensor.⁷⁸ An "active" sale is one that is solicited by the licensee through advertising, mailings, or trade shows.⁷⁹ A "passive" sale is one that is initiated by the customer who might, for example, have found the product on the licensee's website on the Internet, or heard about the product through word of mouth.⁸⁰ In a non-reciprocal agreement,⁸¹ the licensor is also allowed to restrict active sales by the licensee to a territory that is reserved exclusively for another licensee. Where the parties are non-competing undertakings, the ability of the licensor to impose territorial limitations on sales is more limited and such limitations are permitted only on passive sales, not on active sales.⁸²

This scheme set up by the EU permits a licensor—a multinational company that licenses its technology to a licensee in the EU in cases of competing undertakings—to set up separate and exclusive manufacturing and licensed operations for its licensees in separate countries of the EU (i.e. a separate licensee and exclusive contract manufacturer in Germany, France, Luxembourg, Italy, and so forth). The licensor may also wish to reserve an exclusive territory for itself and sell directly to that territory. This creates a type of flexibility attractive to many MNCs: different exclusive licensees in different EU

⁷⁶ See *id.* at Article 3.1 & 3.2.

⁷⁷ The EC Regulation defines "competing undertakings" as those that compete on the relevant technology market (i.e. license out competing technologies or as those undertakings that are actual competitors on the product market). See *id.* at art. 1(j).

⁷⁸ See *id.* at art. 4.1(c)(iv).

⁷⁹ See CHOW & SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 2, at 338.

⁸⁰ See *id.*

⁸¹ A non-reciprocal agreement is one in which there is a single license to use of technology granted by Party A to Party B. A reciprocal agreement would involve a simultaneous license of a second technology by Party B to Party A. See Commission Regulation 2790/1999, on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices, 1999 O.J. (L 336) 23 (EC).

⁸² See Commission Regulation 772/2004, *supra* note 74, at Article 4.2(b)(i)(ii).

countries, each with an expertise in the local language, industry customs, and with access to local customer lists.

2. China Law on Territorial Restrictions in Technology Licensing Agreements

As noted earlier, China does not issue block exemptions to prohibitions contained in the AML and other laws. AML Article 13 prohibits agreements that “[d]ivide sales markets.”⁸³ This could be interpreted to prohibit territory restrictions since these restrictions can be interpreted to divide or create different markets. AML Article 15 provides for an exception to the prohibitions contained in AML Article 13 if the restrictions create benefits that override the anticompetitive effects of the prohibitions.⁸⁴ However, while Article 15

⁸³ See AML art. 13.

⁸⁴ AML Article 15 provides:

If business operators are able to prove that the agreements concluded fall under any of the following circumstances, Articles 13 and 14 of this Law shall not apply:

- (1) To improve technologies or research and develop new products;
- (2) To enhance product quality, decrease cost, increase efficiency, unify product specification, standard, or implement division of work based on specialization;
- (3) To increase operational efficiency of medium and small operators and enhance their competitiveness;
- (4) To save energy, protect environment, assist in disaster relief work, or realize other social public interest;
- (5) To relieve severe decrease of sales or apparent overproduction during times of economic depression;
- (6) To protect legitimate interests in foreign trade and foreign economic cooperation; and

creates exceptions to Article 13, Article 15 does not operate as a block exemption, which automatically creates a safe harbor. Rather, AML Article 15 requires that the licensor must “prove that the agreements falling under Articles 13 and 14” meet the exceptions contained in Article 15. Proof of an exception under AML Article 15 requires convincing the Ministry of Commerce, which has been delegated the authority to implement and enforce the AML.⁸⁵ In addition, Article 29(7) of the PRC Regulations on Administrations of Technology Import and Export (2002) (Regulations on Technology Import and Export) prohibits clauses that “unreasonably restrict the export channels of the products manufactured by the transferee with the imported technology.”⁸⁶ The regulations do not further define what constitutes “unreasonable restrictions,” leaving it up to the enforcement authorities to interpret this standard. MOFCOM is the enforcement authority of these regulations, in addition to being the enforcement authority of the AML.⁸⁷

These provisions raise concerns for MNCs that territorial restrictions might not be permitted in China, allowing a licensor or owner of technology to create exclusive territories for its licensee, such as a licensee and contract manufacturer for China, a separate licensee and manufacturer for Taiwan, a licensee and manufacturer for Vietnam, and so forth. The licensee in China might be permitted by Chinese government authorities to freely export to all of these other

(7) Other circumstances specified by the law or the State Council.

With regard to circumstances in Items (1) to (5) of the preceding paragraph, if Articles 13 and 14 of this Law are not applicable thereto, business operators shall also prove that the agreements concluded would not severely limit competition in the relevant market and may enable consumers to share the interests resulted therefrom.

⁸⁵ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 223.

⁸⁶ See Regulations on Administrations of Technology Import and Export (Promulgated by the State Council on 10 December 2001 and effective as of January 1, 2002) art. 29(7).

⁸⁷ MOFCOM also approves all business entities set up by MNCs in China. These entities are called foreign-invested enterprises, and include joint ventures and wholly foreign owned enterprises. See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 95 (MOFCOM approval of joint ventures) & 138 (MOFCOM approval of wholly foreign owned enterprises). Most MNCs find that obtaining approvals from MOFCOM (or its lower levels) are indispensable to doing business in China.

countries, undermining the attractiveness of a licensing operation in those other countries because many licensees want exclusive territorial markets.

While the AML and the Import and Export Regulations provide for the possibility that territorial restrictions will be struck down, these laws also permit the possibility that the enforcement authorities will permit such restrictions. Licensors need only convince the authorities of the benefits and reasonableness of the restrictions. Of course, obtaining these interpretations requires making contact with the enforcement authorities and opens up the possibility that the authorities will make direct or indirect demands for a quid pro quo—permission in exchange for a payment of money, gifts, travel, or other benefits. These types of exchanges could violate both the U.S. Foreign Corrupt Practices Act and a number of civil and criminal laws in China covering illegal bribes.⁸⁸

3. *Grant-Back Clauses*

a. *EU Law on Grant-Back Clauses*

Many licensors in patent licensing contracts include grant-back clauses that provide that any improvements made to the patented technology by the licensee belong to the licensor.⁸⁹ As noted earlier, the purposes of grant-back clauses are to avoid confusion and create clear rights on who owns the improvements. Many licensors include a grant-back clause that requires the licensee to assign any improvements to the licensor so the licensor owns the improvement.

In determining whether grant-backs of improvements are permitted, EC Regulation No. 772/2004, the block exemption for technology transfer agreements discussed in Part III.C.1 above, distinguishes between grant-backs of “non-severable” improvements and “severable” improvements.⁹⁰

⁸⁸ For a discussion of the issues arising under the Foreign Corrupt Practices Act in China, see Daniel Chow, *China under the Foreign Corrupt Practices Act*, 2012 WIS. L. REV. 574, (2012). For a discussion of issues arising under Chinese law applicable to bribery, see Daniel Chow, *The Interplay Between China's Anti-Bribery Laws and the Foreign Corrupt Practices Act*, 73 OHIO ST. L.J. 1015, (2012).

⁸⁹ For an example of a standard grant-back clause, see CHOW & SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 2, at 344.

⁹⁰ Commission Regulation 772/2004, *supra* note 72, at Article 1.1(n).

Severable improvements are improvements that can be used without using the original licensed patent; non-severable improvements cannot be used without using the original patent. If the licensee, as the inventor of the non-severable improvement, can obtain a patent for the improvement, the licensee, as the owner of the new patent for the non-severable improvement, can prevent the licensor, the owner of the original patent that is the subject of the licensing agreement, from using the patent in the country where the licensing occurs. This is possible because the licensor only owns the original patent that was the subject of the original licensing agreement. The licensor cannot now use the original patent without infringing the new patent for the non-severable improvement later obtained by the licensee.

The EU block exemption for technology transfer agreements prohibits clauses that require the licensee to assign severable improvements to the licensor, which means that the licensee owns the severable improvement.⁹¹ The EU block exemption allows the patent owner to require the grant-back of non-severable improvements to the licensor or owner of the original technology, i.e. improvements that cannot be used without infringing the original patent subject of the license agreement.⁹²

b. China Law on Grant-Back Clauses and Improvements

The AML is silent on the issue of grant-back clauses. To determine the validity of such clauses, we need to begin with Section III Technology Transfer Contracts of the PRC Contract Law (1999). Article 354 of the Contract Law provides that parties to a technology transfer contract may agree upon how to share improvements.⁹³ In the absence of a clause and if the intent of the parties cannot be determined by other conduct, the improvement belongs to the party making the improvement.⁹⁴ Article 27 of the PRC Regulations on Administration of Technology Import and Export (2002) (Regulations on Technology Import and Export) provides that “[d]uring the term of

⁹¹ See *id.* at art. 5.1(b).

⁹² For a discussion on the consequences of legally required grant-backs of non-severable improvements, see discussion in Part III.C.3.b.

⁹³ See Contract Law (Adopted at the Second Session of the Ninth National People's Congress on March 15, 1999) art. 354.

⁹⁴ See *id.*

validity of a technology import contract, the rights in the improvements to the technology shall belong to the party making the improvements.”⁹⁵

The PRC Contract Law, enacted in 1999, is a law of general application and provides a specific section for technology transfer contracts. The Regulations on the Administration of Technology Import and Export, enacted three years later in 2002, applies specifically technology “import” and “export.” A technology import occurs when a foreign entity, such as a U.S.-based MNC, owns foreign technology, e.g., a U.S. patent for an invention.⁹⁶ The MNC then registers a patent for the same invention in China.⁹⁷ This is considered to be an “import” of foreign technology. In a technology transfer contract, the MNC then licenses the patent registered in China to a licensee in China. Of the two laws, the Regulations on Technology Import and Export were enacted later in time than the provisions in the PRC Contract Law and are specifically tailored to technology transfer contracts involving imported technology. This would suggest that Article 27 of the Regulations on Technology Import and Export, which provides that the improvement belongs to the party making the improvement, will likely be the controlling law on this issue and that MOFCOM will be the relevant enforcement authority.

Unlike the EU, China does not distinguish between severable and non-severable improvements but simply takes the position in Article 27 that all improvements belong to the party making the improvements,⁹⁸ which will likely be in most cases the Chinese licensee of the technology transfer contract. In other words, Chinese law prohibits grant-back clauses requiring the licensee to transfer any improvements that it makes to the licensor. If the licensee makes the improvements, the licensee is the owner. If the licensee makes a non-severable improvement and then obtains a patent for the

⁹⁵ See Regulations on Administrations of Technology Import and Export (Promulgated by the State Council on December 10, 2001 and effective as of January 1, 2002) art. 27.

⁹⁶ See *id.* at art. 2.

⁹⁷ So long as the patent owner registers the patent for the same in China within 12 months (not counting the U.S. filing date) of the filing date of the patent application in the U.S., the patent in China will be considered to be “novel” and eligible for patent registration. In fact, the application in China will be entitled to claim the same filing date in China as the filing date of the patent application in the U.S. under the principle of “Paris Priority.” See Paris Convention for the Protection of Industrial Property art. 4 (A)-(C), March 20, 1883, 21 U.S.T. 1583.

⁹⁸ See Regulations on Administrations of Import and Export of Technology art. 27.

improvement, the licensee might be able to prevent the licensor from using the original patent in China once the licensing agreement expires.⁹⁹ This could create a major business disadvantage for the licensor in China.

4. EU and China Law Restrictions on Level of Technology Transferred

a. EU Law

The EU contains no explicit laws on the level technology (whether core or secondary) that the licensor must transfer in the agreement. EU law also does not contain a requirement that a patent owner must license its technology, as opposed to keeping it all in-house. In accordance with the WTO Agreement on TRIPS, however, the EU recognizes a compulsory license for patents,¹⁰⁰ but the conditions for granting such a license are difficult to meet. In addition, a compulsory license is a subject matter that is unrelated to the focus of this article, which is the voluntary transfer of technology in a written licensing agreement.

b. China's Laws

Article 55 of the PRC Anti-Monopoly Law provides that “[w]ith respect to business operators’ acts of exercising intellectual property rights, this law shall . . . apply to business operators’ acts of abusing intellectual property rights to exclude or limit competition.”¹⁰¹ An intellectual property right, such as a patent, confers lawful monopoly rights on its owner, but Article 55 might be read to consider certain acts to be an “abuse” if such conduct “excludes” or “limits competition.” One concern is that AML Article 55 can be read to mean that owners of intellectual property rights registered in China are

⁹⁹ For a discussion of why the owner of a patent for a non-severable improvement to a patent can prevent the owner of the original patent from using it, see discussion in Part III.C.3.

¹⁰⁰ See Commission Regulation 816/2006, on the Compulsory Licensing of Patents Relating to the Manufacture of Pharmaceutical Products for Export to Countries with Public Health Problems, 2006 O.J. (L 157) 1 (EC).

¹⁰¹ See AML (Adopted at the 29th Session of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on August 30, 2007), art. 55.

engaging in “abuse” of those rights if they refuse to provide access to those rights them by licensing their technologies to a licensee. AML Article 55 might also be interpreted to treat a decision to limit access to secondary technologies only and a refusal to license core technologies to constitute an abuse. In other words, AML Article 55 might enable MOFCOM to require MNCs to license technologies that they would otherwise wish to keep in-house or to require MNCs to license their core technologies when they would rather license their secondary technologies.

One context in which MOFCOM exercises a great deal of power and leverage over MNCs, and in which MOFCOM has already imposed conditions related to technology transfer, is in the context of MOFCOM’s approval of mergers and acquisitions (M&A) in China. Many MNCs would prefer to acquire an existing Chinese company rather than set up a new or “greenfield” foreign investment enterprise, such as a joint venture or wholly foreign owned subsidiary, as a way to establish a presence in China.¹⁰² In fact, the acquisition of an existing company is becoming the most commonplace method by which most MNCs enter into new markets through foreign direct investment today.¹⁰³ M&A in China lags behind M&A in other countries because China has been concerned about the acquisition of domestic Chinese companies by MNCs,¹⁰⁴ but China was aware that it could not simply ignore M&A, since these transactions are such a major part of how MNCs invest in foreign countries. When China passed the AML in 2007, the AML contained provisions on M&A based upon years of deliberation and study of laws in the EU and the U.S.¹⁰⁵ In future years, M&A in China is likely to rise in conformity and begin to track the world pattern.¹⁰⁶

Following the approach under the EU merger policy,¹⁰⁷ AML Article 3 prohibits certain mergers and acquisitions from meeting

¹⁰² See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 200.

¹⁰³ See *id.*

¹⁰⁴ See *id.* at 201.

¹⁰⁵ See AML, arts. 20-31.

¹⁰⁶ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 201.

¹⁰⁷ See EU Merger Policy set forth in Council Regulation 139/2004, 2004 O.J. (L, 24) 1.

certain revenue thresholds¹⁰⁸ involving business entities in China, if such M&A transactions could result in concentrations of business operators that eliminate or restrict competition.¹⁰⁹ Such M&A transactions must first be reported to MOFCOM and must receive MOFCOM's approval before the transaction can be completed.¹¹⁰ MOFCOM can approve the M&A transaction,¹¹¹ refuse to approve the M&A transaction,¹¹² or approve the transaction with certain conditions.¹¹³ MOFCOM also has the authority to exercise continuing supervision and monitoring of the M&A transaction after its completion in order to ensure that any required conditions are met.¹¹⁴

In the 2009 acquisition of Wyeth, an MNC in the pharmaceuticals industry, by Pfizer, an MNC also in the pharmaceuticals industry, Pfizer applied to MOFCOM for approval of the acquisition.¹¹⁵ Both Pfizer and Wyeth had existing business entities in China that manufactured human medications and animal products. As China's

¹⁰⁸ See AML, art. 21 (requiring notification to MOFCOM if the M&A transaction will result in meeting certain economic thresholds as set forth by the State Council). The State Council subsequently issued the Provisions of the State Council on the Thresholds for Declaring Concentration of Business Operators (2008). Article 3 of the Thresholds Provisions provides notification to MOFCOM where the worldwide revenues of all of the business operators to the proposed M&A exceed RMB 10 billion (about \$1.6 billion) with at least two business operators achieving revenues of over RMB 400 million (about \$66 million) the previous year; or the total turnover within China of all of the parties to the M&A was at least RMB 2 billion (about \$333 million) during the previous year with at least two business operators each achieving a turnover of at least RMB 400 million (about \$66 million) during the previous year.

¹⁰⁹ See AML, art. 3(3).

¹¹⁰ See AML, art. 28. Note that although Article 28 refers to the State Council as the approval authority, the State Council subsequently delegated this authority to MOFCOM.

¹¹¹ See *id.*

¹¹² See *id.*

¹¹³ See AML, art. 29.

¹¹⁴ See MOFCOM Announcement No. 76, 2009, Notice of Anti-Monopoly Review Decision on Conditionally Approving General Motors Corporation to Acquire Delphi Corporation (Sept. 28, 2009) (requiring General Motors and Delphi to periodically report to MOFCOM concerning compliance with certain conditions imposed as a prerequisite for approval of the acquisition).

¹¹⁵ See MOFCOM Announcement No. 77, 2009, Notice of Anti-Monopoly Review Decision on Conditionally Approving Pfizer Corporation to Acquire Wyeth Corporation (Sept. 29, 2009).

business entities owned by both Wyeth and Pfizer were involved, MOFCOM's approval was necessary before the worldwide acquisition of Wyeth by Pfizer could be completed. A refusal by MOFCOM of the M&A in China would probably have prevented the worldwide acquisition, since the Chinese entities belonging to Pfizer and Wyeth could not have been merged. MOFCOM approved the acquisition but imposed several divestiture conditions in order to avoid the anti-competitive effects of the transactions. MOFCOM required the divestiture of both physical assets and non-physical assets, including intellectual property rights.¹¹⁶ The divestiture of intellectual property rights required Pfizer to sell those rights to a purchaser, which could include a local Chinese company. MOFCOM also stated that for three years following the divestiture of some of its businesses, Pfizer was obligated to provide "reasonable technical support"¹¹⁷ and "technical training and consultation to the purchaser."¹¹⁸ Reasonable technical support, training, and consultation to the purchaser, such as a Chinese company, would include the provision of training involving know-how, which might be protectable as a trade secret.¹¹⁹ The Pfizer decision provides an example of how MOFCOM could require, as a condition of approval of an M&A transaction, that the MNC provide access to intellectual property rights by selling its rights and by providing know-how. It is not too far of a leap to envision a case in which MOFCOM would require that an MNC license, or even assign, its core technologies to a Chinese entity as a condition of approval of an M&A transaction. Suppose, for example, that an MNC sought to acquire a Chinese company in a high technology industry. Once acquired by the MNC, the Chinese company would be converted into a wholly foreign owned enterprise (WFOE), a foreign-invested enterprise under applicable Chinese law.¹²⁰ The WFOE, although

¹¹⁶ *See id.*

¹¹⁷ *See id.*

¹¹⁸ *See id.*

¹¹⁹ *See* Anti-Unfair Competition Law (Adopted at the Third Session of the Standing Committee of the Eighth National People's Congress on September 2, 1993) art. 10 (defining a trade secret as "technical information and business information that is unknown to the public, can bring economic benefits to the right owner, is of a practical nature and is protected by confidentiality measures taken by the right owner").

¹²⁰ *See* CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 163 (discussing how a foreign invested enterprise is a business entity in which the foreign investor (an MNC) has at least a twenty-five percent equity ownership. Once an MNC acquires a domestic Chinese

wholly owned by the MNC, is treated as a Chinese business entity formed under domestic Chinese law. It is entirely plausible that MOFCOM would require the MNC to license its most advanced technology to the WFOE as a condition of approval of the acquisition. As competition law, with one exception that is not applicable in China,¹²¹ is outside of the scope of the WTO, there would be no legal recourse if MOFCOM refuses to approve an M&A without a requirement that one of the parties must transfer technology as a condition of approval.

Aside from the AML, Article 48 of the PRC Patent Law also allows a party to apply to the Patent Authority for a compulsory license, i.e. a license imposed upon the patent owner when the patent owner is deemed to have committed a "monopolistic act" and the license will mitigate the adverse impact of such act.¹²² Nothing in Article 48 further defines what constitutes a "monopolistic act." Article 48 appears to be inconsistent with the requirements of TRIPS, which does not recognize a monopolistic act as a basis for the issuance of a

company and so has 100 percent equity ownership, the MNC will be required to convert the domestic Chinese company into a foreign invested enterprise, such as a wholly foreign owned subsidiary (WFOE)).

¹²¹ The Telecommunications Agreement is a specialized WTO agreement that contains competition clauses, but this agreement applies only to those countries that sign it and is a specialized agreement of the General Agreement on Trade in Services applicable to countries with state owned telecommunications enterprises, which pose special competition concerns as these companies exercise monopoly power. See CHOW & SCHOENBAUM, *INTERNATIONAL TRADE LAW*, *supra* note 14, at 557.

¹²² Patent Law (Adopted at the Fourth Session of the Standing Committee of the Sixth National People's Congress on March 12, 1984; Third Amendment made According to the Decision of the Sixth Session of the Standing Committee of the 11th National People's Congress on Revising the "Patent Law of the People's Republic of China" on 27 December 2008). Art. 48 provides in relevant part:

Under any of the following circumstances, the Patent Administration Department under the State Council may, upon the application of any organization or individual that possesses exploitation conditions, grant a compulsory license for the exploitation of an invention patent or utility model patent . . . (2) The patentee's act of exercising the patent right is determined as monopoly in accordance with the law and the negative impact of such an act on competition needs to be eliminated or reduced.

compulsory license.¹²³ As of now, no country has raised this issue before the WTO, so Article 48 is still valid law in the PRC.

Article 350 of Section III of the PRC Contract Law created an addition (Technology Transfer Contracts). Article 350 provides that “[t]he transferor in a technology transfer contract shall guarantee its legitimate ownership over the technology provided and guarantee the technology provided to be complete, errorless, effective, and capable of attaining the contracted goal.”¹²⁴ This provision could be read to create an absolute warranty that the technology will be flawless and must achieve a certain result; the transferor of the technology, such as a licensor might be liable for damages if the technology fails to achieve the expected result. Nothing like this provision exists in EU law.

IV. CONCLUSION: SOME REASONS FOR DIFFERENCES BETWEEN EU AND CHINA’S LAWS ON TECHNOLOGY TRANSFER

An examination and comparison of EU and China competition law relating to technology transfers illustrate some significant differences between the two regimes. These differences are significant and exist even though China has intentionally sought to model its laws after competition laws in the EU, as both China and the EU have civil law systems. A comparison of EU and Chinese law on several important aspects of technology transfer contracts (i.e. territorial restrictions, grant-back clauses, and level of technology) indicates that Chinese law is much more restrictive and protective of the recipient of technology. Of course, competition law in the EU and China are multi-faceted and complex, and this article focused on only three issues; many more issues exist on both similarities and differences between the EU and China competition law. For example, price fixing and limitations on production, and tying obligations are prohibited under both EU¹²⁵ and Chinese competition law.¹²⁶ Both EU and Chinese competition law

¹²³ See TRIPS, art. 31(a)-(l), Apr. 15, 1994, Marrakesh Agreement Establishing the WTO, Annex 1C, 1869 U.N.T.S. 299 (1994) (setting forth the grounds and conditions upon which a compulsory license can be issued).

¹²⁴ See Contract Law (Adopted at the Second Session of the Ninth National People’s Congress on March 15, 1999) art. 350.

¹²⁵ See Commission Regulation 772/2004, *supra* note 72, at art. 4.1(a)-(b) (prohibiting restrictions fixing prices or on output).

¹²⁶ See AML (Adopted at the 29th Session of the Standing Committee of the Tenth National People’s Congress of the People’s Republic of China on 30 August 2007) art. 13(1)-(2) (prohibiting price fixing and limits on production); Regulations on Administrations of

also prohibit clauses that prevent the licensee from making improvements.¹²⁷

Although this study has focused on only selected issues under EU and Chinese competition law, we can draw several general conclusions applicable to competition law generally and possibly applicable to other areas of business law as well. First, EU law is highly technical and extremely precise, and far exceeds Chinese competition law in these respects. The EU starts out with a general prohibition in TFEU Article 101(1) against agreements with an anti-competitive object or effect and then issues a series of block exemptions that create a safe harbor. The EU draws technical distinctions between “competing” and “non-competing undertakings” and between “active” and “passive” sales in assessing territorial restrictions in technology transfer contracts and between severable and non-severable improvements in assessing the validity of grant-back clauses.¹²⁸ The EU Commission plays an active role in promulgating block exemptions and is constantly studying, revising, and fine-tuning these exemptions based upon experience.¹²⁹ The EU Commission also plays a major role in implementing EU law, but ultimately the duty of interpreting EU competition law (and all EU law) is within the jurisdiction of the ECJ, a high court that regularly issues opinions on all aspects of EU law.¹³⁰ In the area of competition law, the ECJ can overrule decisions by the EU Commission.¹³¹ Although EU competition law is highly complex, it offers the advantages of predictably and of being a system in which power is shared between several institutions, and is one in which the ECJ can reign in the EU Commission when necessary in the area of competition law.

In China, competition law is less systematically organized. While the AML is a major piece of legislation in this area, laws that pertain to

Technology Import and Export (Promulgated by the State Council on 10 December 2001 and effective as of 1 January 2002) art. 29(1) (prohibiting tying arrangements).

¹²⁷ See Commission Regulation 772/2004, *supra* note 72, at art.4.1(d); Regulations on Administrations of Technology Import and Export art. 29(3).

¹²⁸ See Part III.C *supra*.

¹²⁹ The EU Commission reissues revised block exemptions periodically.

¹³⁰ See Part III.A *supra*.

¹³¹ See, e.g., Case T-5/02, *Tetra Laval BV v. Comm'n*, 2002 E.C.R. II-4381 (ECJ annulling decision by EC Commission that blocked an acquisition by Tetra Laval, a privately held French company, of Sidel, a public corporation also with its headquarters in France).

competition are scattered throughout China's laws and many different authorities potentially have authority over aspects of the law. For example, the Administration of Industry and Commerce and the Public Security Bureau have jurisdiction to enforce competition laws pertaining to trade secrets and trademarks.¹³² Courts have jurisdiction to enforce provisions of the PRC Contract Law that pertain to technology transfer contracts.¹³³ Part of the explanation lies in the late development of the AML, issued only in 2007, so it was issued on top of an existing set of laws already dealing with certain aspects of competition. China's laws also do not follow the model of a broad prohibition with block exemptions; rather, the burden is upon the MNC to read and discover all applicable laws, which include local legislation, often controlling and very important.¹³⁴ In addition, in certain major areas of competition law, such as M&A, which implicates technology transfer, MOFCOM is the supreme authority.¹³⁵ While it is theoretically possible to challenge an adverse decision by MOFCOM with the State Council, China's executive arm, no MNC feels that this is a realistic possibility since MNCs believe that MOFCOM might retaliate against them.¹³⁶ MOFCOM plays a major

¹³² See Anti-Unfair Competition Law (Adopted at the Third Session of the Standing Committee of the Eighth National People's Congress on September 2, 1993) art. 3 (delegating enforcement authority to administrations of industry and commerce); art. 5 (prohibiting trademark infringements, passing off, and selling of counterfeits); art. 10 (prohibiting theft of trade secrets). The Public Security Bureau (the police) has exclusive authority to initiate all criminal cases. See CHOW, *LEGAL SYSTEM OF CHINA*, *supra* note 54, at 263. Theft of trade secrets can constitute a crime. See Criminal Law (Adopted at the Second Session of the Fifth National People's Congress on July 1, 1979; revised at the Fifth Session of the Eighth National People's Congress on March 14, 1997) art. 219(1).

¹³³ See Contract Law (Adopted at the Second Session of the Ninth National People's Congress on March 15, 1999) art. 128 (providing that in addition to mediation and arbitration, parties may also bring a case in a court for disputes arising under the Contract Law).

¹³⁴ See Part III.B *supra*.

¹³⁵ See *id.*

¹³⁶ See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 227-28. See *id.* According to MOFCOM's own report, as of December 26, 2012, MOFCOM received a total of 201 M&A notifications, accepted 186 notifications, and resolved 154 notifications this year, including 6 approved with conditions and 142 notifications approved without conditions. Six notifications were withdrawn. No reason was given for why 15 notifications were not accepted for filing. See <http://english.mofcom.gov.cn/article/newsrelease/press/201301/20130108513014.shtml>. The author has been unable to find records of any appeals of MOFCOM decisions to the State Council.

role not only in enforcing the AML, but in all aspects of foreign direct investment, so MNCs must deal with MOFCOM on a regular basis.¹³⁷ MOFCOM's powers are increased by what appears to be the intentional vagueness of Chinese competition law. Key terms such as "abuse" of intellectual property rights and "unreasonable" territorial restraints in technology transfer agreements are left undefined¹³⁸ and are open to interpretations by MOFCOM.

One set of conclusions that we can reach from this comparison is that EU law is more precise and predictable than Chinese competition law, EU institutions have clearly defined roles, and the ECJ has a check on the EU Commission's exercise of power. In China, laws are less precise and scattered, and local legislation remains paramount in many cases. MOFCOM, China's counterpart to the EU Commission in the area of competition law, reigns supreme and, in practice, is the final authority on competition law issues, including technology transfer, although other entities might be involved. The unpredictability of Chinese law and a concentration of power in one or a few government entities increase transactions costs in China; MNCs also feel under pressure to cultivate relationships with enforcement authorities as these authorities have such broad discretion in business matters, including technology transfer. Cultivating relationships, while necessary, also brings added risks as China has a culture of both petty and serious corruption when MNCs are forced to become entangled with government entities in order to secure needed approvals. These risks are high and must be taken seriously by all MNCs doing business in China.¹³⁹

Some observers argue certain features of Chinese competition law that seem to be more protective of the recipient of the technology are remnants of an era in which China did not trust MNCs. Only two decades ago, as a developing country just starting on the path of industrializing, China did not trust foreign multinationals and was afraid that crafty and experienced business-minded foreign companies would exploit inexperienced Chinese innocents.¹⁴⁰ Such attitudes might explain the requirement that the transferor of technology provide what amounts to an absolute warranty.¹⁴¹ Some observers

¹³⁷ *See id.*

¹³⁸ *See* Part III.C *supra*.

¹³⁹ *See* note 87 *supra*.

¹⁴⁰ *See* CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 5, at 357.

¹⁴¹ *See* note 124, *supra*.

believe that China's current technology transfer still reflect these outdated attitudes.¹⁴² China today has the world's second largest economy and many business persons in China are experienced and sophisticated in dealing with western MNCs. China, however, does not have a practice of regularly repealing laws but often adds new laws to a layer of existing ones. This practice indicates that while circumstances may have changed with China's economic development, remnants of laws from an earlier era are likely to be on China's books for the foreseeable future. These older laws create an additional level of unpredictability.

Finally, some observers might believe that China's restrictive technology transfer laws really are designed to force companies to set up their own operations in China, such as a WFOE (which could involve tens of millions of dollars of capital investment), because transfer of advanced technology to an entity that is wholly owned by the U.S. multinational or licensor helps to mitigate some of the risks (such as grant-back of improvements) created by China's current laws.¹⁴³ This view is linked to China's rise as a market for global investment and the attractiveness of China as a destination for foreign direct investment. The argument is that as MNCs compete and clamor for entry into the Chinese market, the Chinese government, in a position of strength, can set high demands relating to access to advanced technology as a price of entry into the market.

The author's own view is that seeking to avoid the pitfalls created by restrictions in China's technology transfer laws through setting up a wholly foreign owned enterprise to serve as the recipient of core technology will create a host of new issues, such as theft and misappropriation of the technology, and piracy.¹⁴⁴ Depending upon

¹⁴² See *id.*

¹⁴³ This observation is based upon discussions by the author with business and legal officials of U.S. companies. There appears to be a general concern that China attempts to use various strategies to induce or pressure U.S. companies to transfer their technologies to China. See Daniel Chow, *China's Indigenous Innovation Policies and the World Trade Organization*, 34 NW. J. INT'L L. & BUS. (forthcoming 2013) (discussing why some U.S. companies believe that China's policies relating to government procurement are designed to "force" U.S. companies to transfer their technology to China where it will be stolen).

¹⁴⁴ For a discussion of counterfeiting and commercial piracy issues, one of the worst business problems for MNCs in China, see Daniel Chow, *Anti-Counterfeiting Strategies of Multinational Companies in China*, 41 GEO. J. INT'L L. 749 (2010). The theft of trade secrets is also a major issue in China. See Marisa Anne Pagnattaro, *Preventing Know-How from Walking out the Door in China: Protection of Trade Secrets*, 55 BUSINESS HORIZONS 329 (2012).

the circumstances, these new concerns might be more serious than the pitfalls that the MNC is trying to avoid. While China has vast potential, China also offers a highly complex business, legal, and political environment in which avoiding one set of problems might lead to a new, even more serious, set of problems. Of course, decisions to establish a WFOE in China or to acquire an existing Chinese company under the AML are driven by a host of concerns that extend beyond constraints created by China's existing technology transfer laws. But the risks created by China's technology transfer laws, as highlighted by a comparison to laws in the EU, and the risks created by the need to protect intellectual property rights in general in China, should be carefully considered and a plan should already be in place before an MNC, or any business entity, decides to expose its technology to the risks created by entering the China market.